

REPORT OF EXAMINATION
OF THE
RESIDENCE MUTUAL INSURANCE COMPANY

AS OF
DECEMBER 31, 2009

Participating State
and Zone:

California

Filed June 27, 2011

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Los Angeles, California
May 27, 2011

Honorable Joseph Torti, III
Chairman of the NAIC Financial
Condition Subcommittee
Superintendent of Business Regulation
Division of Insurance
Cranston, Rhode Island

Honorable Linda S. Hall
Secretary, Zone IV-Western
Director of Insurance
Alaska Division of Insurance
Anchorage, Alaska

Honorable Dave Jones
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman, Secretary, and Commissioner:

Pursuant to your instructions, an examination was made of the

RESIDENCE MUTUAL INSURANCE COMPANY

(hereinafter also referred to as the Company) at its statutory home office and primary location of its books and records, 2172 Dupont Drive, Irvine, California 92612.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2006. This examination covers the period from January 1, 2007 through December 31, 2009. The examination was made pursuant to the National Association of Insurance Commissioners' plan of examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2009, as deemed necessary under the circumstances.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; loss experience; accounts and records; and sales and advertising.

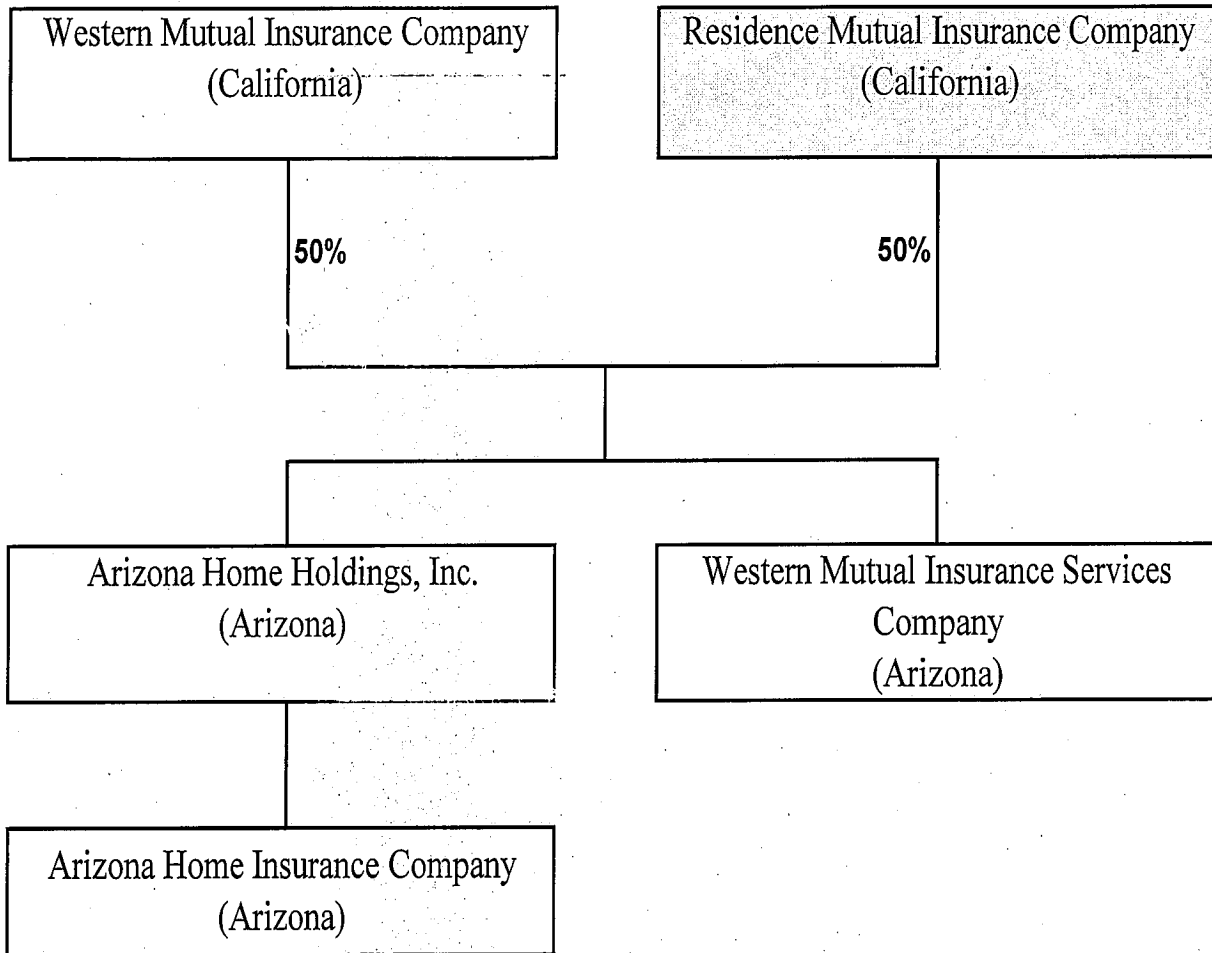
This examination was conducted concurrently with the examination of the Company's California affiliate, Western Mutual Insurance Company. The examination was also coordinated with the examination of the Company's Arizona subsidiary, Arizona Home Insurance Company, which was performed by the Arizona Department of Insurance.

COMPANY HISTORY

The Company and its affiliate, Western Mutual Insurance Company, each purchased 50% of the outstanding common stock of Western Mutual Insurance Services Company (WMISC) on May 27, 2008. WMISC is an insurance agency licensed in Arizona.

MANAGEMENT AND CONTROL

The following organizational chart depicts the Company's relationship with its affiliates:



(*) all ownership is 100% unless otherwise noted

Management of the Company is vested in a six-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2009 follows:

Directors

Name and Residence

Principal Business Affiliation

Michael Antonovich
Glendale, California

Supervisor
Los Angeles County Board of Supervisors

John Barcal
La Habra Heights, California

Attorney
John J. Barcal, Inc.

Catherine Berryman
Poway, California

Private Investor

Joe Crail
Pacific Palisades, California

Chairman of the Board and President
Western Mutual Insurance Group

Lucile Ann Crail
Silverton, Oregon

Private Investor

Paul Rubincam
Palos Verdes Estates, California

Retired Insurance Executive

Principal Officers

Name

Title

Joe Crail
Daniel Greulich
Michael Hardy
Paul Calvet

President and Chief Executive Officer
Senior Vice President of Claims and Secretary
Vice President and Chief Financial Officer
Senior Vice President and Chief Operating
Officer

Management Agreements

Service Agreement (Agreement): Effective January 1, 2006, the Company, Western Mutual Insurance Company (WMIC), and Arizona Home Insurance Company (AHIC) entered into the Agreement whereby the participants cooperate in the performance of certain administrative and special services and share in the use of the day to day operations of certain property, equipment, and facilities. The shared functions provided include the following: accounting and auditing, premium collection, underwriting, claims, actuarial, data processing, legal, and payroll. Costs of the services are allocated at cost in accordance with the pooling percentages; 53% to the Company, 35% to WMIC and 12% to AHIC. The Agreement requires that the charges be settled within 30 days after each quarter. During the years 2007, 2008, and 2009, the Company paid \$7,702,905, \$7,752,022 and \$8,540,411 respectively, in fees to its affiliates under the terms of this Agreement. The California Department of Insurance approved this Agreement on February 8, 2008.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2009, the Company was licensed to transact multiple lines of property and casualty insurance. The following is a listing of the states in which the Company is licensed:

California	New Mexico
Colorado	Texas
Nevada	Utah

In 2009, the Company wrote \$40.4 million of direct premiums. All of the direct premiums written were written in California. The lines of business written were homeowners multiple peril (86.3%), earthquake (5.6%), fire (4.1%), and allied lines (4.0%).

Policies are issued exclusively on residential properties. Business is produced on a direct basis as well as through agencies and brokers.

REINSURANCE

Intercompany Pooling Agreement

The Company and its affiliates, Western Mutual Insurance Company (WMIC) and Arizona Home Insurance Company (AHIC) participate in an intercompany Pooling Agreement (Agreement). The Company's participation in the pool is 53%, WMIC's participation is 35%, and AHIC's participation is 12%. Under the terms of the Agreement, all the premiums written by the Company and AHIC are ceded to and pooled with those written by WMIC. The combined premiums, net of cessions pertaining to all other reinsurance agreements, are then retro ceded to the individual Companies. Losses, loss adjustment expenses, and underwriting expenses are also combined and pooled in the same percentages. The Agreement was approved by the California Department of Insurance on December 27, 2007.

Assumed

Other than business assumed under the terms of the Intercompany Pooling Agreement, the Company does not assume any business.

Ceded

The following is a summary of the principal ceded reinsurance treaties inforce as of December 31, 2009:

Type of Contract	Percentage of Participation & Reinsurer's Name	Company's Retention	Reinsurer's Maximum Limits
1 st Property & Casualty Excess Per Risk	100.00% Maiden Reinsurance Company	\$250,000	\$250,000 in excess of \$250,000 each risk. \$750,000 maximum per occurrence
2 nd Property & Casualty Excess Per Risk	100.00% Maiden Reinsurance Company	\$500,000	\$500,000 in excess of \$500,000 each risk. \$1 million maximum per occurrence
3 rd Property & Casualty Excess Per Risk	100.00% Maiden Reinsurance Company	\$1 million	\$1 million in excess of \$1 million each risk. \$2 million maximum per occurrence
1 st Catastrophe Layer	33.50% Lloyds of London 12.50% Flagstone Reinsurance Limited 12.50% R + V Verischerung AG 7.50% American Agricultural Ins. Co. 7.50% QBE 7.50% SCOR Reinsurance Company 5.00% Toa Reinsurance Company of America 14.00% Others	\$2.5 million	100% of \$5 million in excess of \$2.5 million each occurrence.
2 nd Catastrophe Layer	28.50% Lloyds of London 12.50% R + V Verischerung AG 11.00% Flagstone Reinsurance Limited 7.50% American Agricultural Ins. Co. 7.50% SCOR Reinsurance Company 7.50% Allianz SE 5.00% QBE 5.00% Paris Re 15.50% Others	\$7.5 million	100% of \$12.5 million in excess of \$7.5 million each occurrence.
3 rd Catastrophe Layer	32.50% Lloyds of London 12.50% Allianz SE 10.00% Mapfre 10.00% R + V. Versicherung AG 7.50% American Agricultural Ins. Co. 7.50% SCOR Reinsurance Company 5.00% Paris Re 15.00% Others	\$20 million	100% of \$30 million in excess of \$20 million each occurrence.

As of December 31, 2009, reinsurance recoverables, for all ceded reinsurance totaled \$6.6 million or 13.6% of surplus as regards policyholders. Approximately \$6.5 million of the reinsurance recoverables resulted from the Intercompany Pooling Agreement. The remaining \$81 thousand of ceded reinsurance recoverables were from nonaffiliated authorized reinsurers.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2009

Underwriting and Investment Exhibit for the Year Ended December 31, 2009

Reconciliation of Surplus as Regards Policyholders
from December 31, 2006 through December 31, 2009

Statement of Financial Condition
as of December 31, 2009

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 48,916,631	\$	\$ 48,916,631	
Stocks:				
Common stocks	12,106,040		12,106,040	
Real estate – occupied by the company	5,771,398		5,771,398	
Cash	6,873,097		6,873,097	
Investment income due and accrued	636,684		636,684	
Premiums and considerations:				
Premiums and agents' balances in course of collection	1,074,482	3,665	1,070,817	
Reinsurance:				
Amounts recoverable from reinsurers	51,652		51,652	
Current federal income tax recoverable	228,072		228,072	
Net deferred tax asset	997,000		997,000	
Electronic data processing equipment	4,460	4,460		
Aggregate write-ins for other than invested assets	<u>549,629</u>	<u>3,800</u>	<u>545,829</u>	
Total assets	<u>\$ 77,209,145</u>	<u>\$ 11,925</u>	<u>\$ 77,197,220</u>	
<u>Liabilities, Surplus and Other Funds</u>				
Losses			\$ 6,206,382	(1)
Loss adjustment expenses			2,703,000	(1)
Commissions payable			1,182,999	
Other expenses			1,641,236	
Taxes, licenses and fees			10,065	
Unearned premiums			16,039,954	
Ceded reinsurance premiums payable			296,226	
Aggregate write-ins for liabilities			<u>585,593</u>	
Total liabilities			28,665,455	
Unassigned funds (surplus)		<u>\$ 48,531,765</u>		
Surplus as regards policyholders			<u>48,531,765</u>	
Total liabilities, surplus and other funds			<u>\$ 77,197,220</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2009

Statement of Income

Underwriting Income

Premiums earned		\$ 27,510,099
Deductions:		
Losses incurred	\$ 9,390,692	
Loss adjustment expenses incurred	4,110,622	
Other underwriting expenses incurred	<u>10,229,708</u>	
Total underwriting deductions		<u>23,731,022</u>
Net underwriting gain		3,779,077

Investment Income

Net investment income earned	\$ 1,985,614	
Net realized capital losses	<u>(17,753)</u>	
Net investment gain		1,967,861

Other Income

Finance and service charges not included in premiums	<u>\$ 210,905</u>	
Total other income		<u>210,905</u>
Net income before federal income taxes		5,957,843
Federal income taxes incurred		<u>1,576,419</u>
Net income		<u>\$ 4,381,424</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2008		\$ 42,323,642
Net income	\$ 4,381,424	
Net unrealized capital gains	2,046,487	
Change in net deferred income tax	(260,000)	
Change in nonadmitted assets	<u>40,212</u>	
Change in surplus as regards policyholders		<u>6,208,123</u>
Surplus as regards policyholders, December 31, 2009		<u>\$ 48,531,765</u>

Reconciliation of Surplus as Regards Policyholders
from December 31, 2006 through December 31, 2009

Surplus as regards policyholders, December 31, 2006, per Examination \$ 32,080,161

	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>
Net income	\$ 14,677,774	\$
Net unrealized capital gains	1,704,388	
Change in net deferred income tax		101,000
Change in nonadmitted assets	<u>170,442</u>	
Totals	<u>\$ 16,552,604</u>	<u>\$ 101,000</u>

Net increase in surplus as regards policyholders 16,451,604

Surplus as regards policyholders, December 31, 2009, per Examination \$ 48,531,765

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

Based on an analysis by a Casualty Actuary for the California Department of Insurance, the Company's loss and loss adjustment expense reserves as of December 31, 2009, were found to be reasonably stated and have been accepted for purposes of this examination

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

None.

Previous Report of Examination

None.

ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

/S/

Gregory J. Lieber, CFE
Examiner-In-Charge
Senior Insurance Examiner
Department of Insurance
State of California